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IRS' Budget Request for Fiscal Year 1993

Statement of
Jennie S. Stathis, Director
Tax Policy and Administration Issues
General Government Division

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IRS' BUDGET REQUEST
FOR FISCAL YEAR 1993

SUMMARY STATEMENT OF
JENNIE S. STATHIS
DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES
GENERAL GOVERNMENT DIVISION
U.S. GENERAL ACCOUNTING OFFICE

The administration's fiscal year 1993 budget request for the Internal Revenue Service (IRS) is for 115,798 Full Time Equivalent (FTE) staff years and about $7.24 billion. That is 414 FTEs less and $562 million more than authorized for last year. GAO's testimony makes several points:

-- The budget includes two initiatives that would provide more staff for IRS to examine more returns and collect more delinquent taxes. Although GAO has supported such initiatives in the past, data in the budget and other IRS data raise questions about their long term effect. Despite additional staffing authorized for Collection and Examination in fiscal year 1991 and the additional staffing being requested in this budget, IRS' projections for fiscal year 1993 show minimal growth in Collection staffing and a decline in Examination staffing compared to fiscal year 1990. This is because IRS has been unable to sustain the funding needed to maintain increased staffing levels.

-- IRS' inability to sustain any growth in Collection and Examination staff comes at a time when the trends in accounts receivable are bad and audit coverage is projected to again fall below 1 percent.

-- The fiscal year 1993 budget for another enforcement effort, the Information Returns Program, indicates a decline of 1,307 staff years since 1991. IRS projects that the number of underreporter cases worked under this Program in 1992 will be about 38 percent less than the number worked in 1991.

-- The fiscal year 1993 budget includes about $50 million in expected productivity savings from new or enhanced computer systems. Most of these savings, like those in the fiscal year 1992 budget, appear to have been based on unrealistic assumptions. As a result, programs are being cut to reflect "savings" that are not really there.

-- The inclusion of productivity savings in IRS' budget reflects the administration's understandable desire to show benefits from IRS' systems modernization effort. The biggest benefits from modernization could come, in our opinion, from major changes in the way IRS does business. IRS needs to ask itself whether its current organizational structure still makes sense in light of the opportunities afforded by modernization. Opportunities for change might include the consolidation of field locations and the establishment of cross-functional telephone service.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its review of the administration's fiscal year 1993 budget request for the Internal Revenue Service (IRS). This request is for 115,798 Full Time Equivalent (FTE) staff years and about $7.24 billion. Although this request would reduce IRS' authorized staffing level by 414 FTEs, it would increase funding by about $562 million, or 8.4 percent over IRS' authorized funding level for fiscal year 1992.

The $562 million increase is net of various increases and decreases. The increases include requests for (1) $342.7 million to "maintain an adequately-supported workforce", (2) $187.2 million for Tax Systems Modernization (TSM), (3) $123.4 million to maintain or upgrade existing computer systems, and (4) $52.0 million for various program initiatives. The decreases include (1) $52.2 million in expected productivity savings from new or enhanced computer systems, (2) $33.7 million in fiscal year 1992 costs that are not expected to recur in fiscal year 1993, and (3) $57 million in various program reductions.

My testimony today makes the following points:

-- First, this budget projects minimal growth in Collection staffing and a decline in Examination staffing as compared to fiscal year 1990. This is despite the additional staffing authorized by fully-funded fiscal year 1991 enforcement initiatives and the additional staffing being requested for new initiatives in 1993. The budget also projects a nearly one-quarter drop in staffing for the Information Returns Program between fiscal years 1991 and 1993.

-- Second, this lack of growth in enforcement staffing comes at a time when certain enforcement statistics continue to show negative trends. For example, the accounts receivable inventory is still growing at a faster pace than delinquent tax collections and audit coverage is projected to again fall below 1 percent.

-- Third, much of the anticipated productivity savings in the fiscal year 1993 budget, like those in the fiscal year 1992 budget, appear to have been based on unrealistic assumptions. The result is that programs are being cut to reflect "savings" that are not really there. We believe that some of the decline in the staffs of Collection, Examination, and Information Returns is attributable to such cuts.

-- Fourth, notwithstanding my previous point, we believe that American taxpayers have a right to expect to see some payback from the considerable investment in TSM. The biggest payback could come, in our opinion, from major changes in the way IRS does business.

Also, in response to your request, we are providing some thoughts on the resource levels for three specific IRS functions--Taxpayer Service, Criminal Investigations, and Exempt Organizations.

IRS UNABLE TO SUSTAIN GROWTH FROM PAST ENFORCEMENT INITIATIVES

The fiscal year 1993 budget request includes about $42.7 million and 588 FTEs for 8 enforcement initiatives. The two largest initiatives call for (1) about $16.2 million and 397 FTEs to collect delinquent accounts and (2) $12.8 million and 121 FTEs to audit high income/asset individual and corporate tax returns. Other smaller initiatives are for such things as criminal investigations and international compliance.

Although we have been supportive of such initiatives in the past, staffing data in the budget request and other information we obtained from IRS raise questions about the long-term effect of these initiatives. Periods of hiring to bring on additional enforcement staff authorized by Congress have been followed by hiring freezes to bring staff down to levels that IRS could sustain with available funding. The results have been a stop-and-start hiring cycle that disrupts orderly recruiting and training programs and a failure to achieve the sustained growth in enforcement resources that Congress intends when it authorizes increased funding.

Like the budget for fiscal year 1993, IRS' fiscal year 1991 appropriation contained funding for several enforcement initiatives, including one for collecting more delinquent accounts and another for auditing more returns. These two initiatives provided for about 1,600 additional Collection and Examination staff, most of whom were to be revenue officers and revenue agents. Internal reports indicate that IRS subsequently hired a considerable number of revenue officers and revenue agents, primarily between January and August 1991. The reports also show, however, that the number of these staff peaked in August 1991 and has declined ever since.

As shown in table 1, despite the hiring activity in 1991 and the staffing increase associated with the fiscal year 1993 initiatives, the estimated number of revenue officer FTEs in 1993 is only 170 more than the actual number in fiscal year 1990. The estimated number of revenue agent FTEs in 1993 is less than in 1990.

Table 1: Revenue Officer and Revenue Agent Staffing Levels (FTEs)

	a. 1990 Actual	b. Fiscal Years 1991 and 1993 Initiatives	c. Total	d. 1993 Budget Estimate	e. Shortfall (d-c)
Revenue Officers	7,601	+796	8,397	7,771	(626)
Revenue Agents	15,526	+712	16,238	15,519	(719)

Source: IRS budget data.

Recognizing that not all collection actions are taken by revenue officers and not all audits are done by revenue agents, we also tracked IRS' budget information for total Collection and Examination staffing. That information also shows little, if any, growth. For fiscal year 1993, IRS expects to realize 19,992 total Collection FTEs--only 122 more than in fiscal year 1990--and 30,540 total Examination FTEs--342 less than in 1990.

IRS attributes its inability to sustain the funding levels needed to maintain increased enforcement staffing to several factors, including the need to cover unbudgeted costs. Another contributing factor to the absence of staffing growth in Examination and Collection is that staffing levels in those functions are being reduced by productivity "savings".

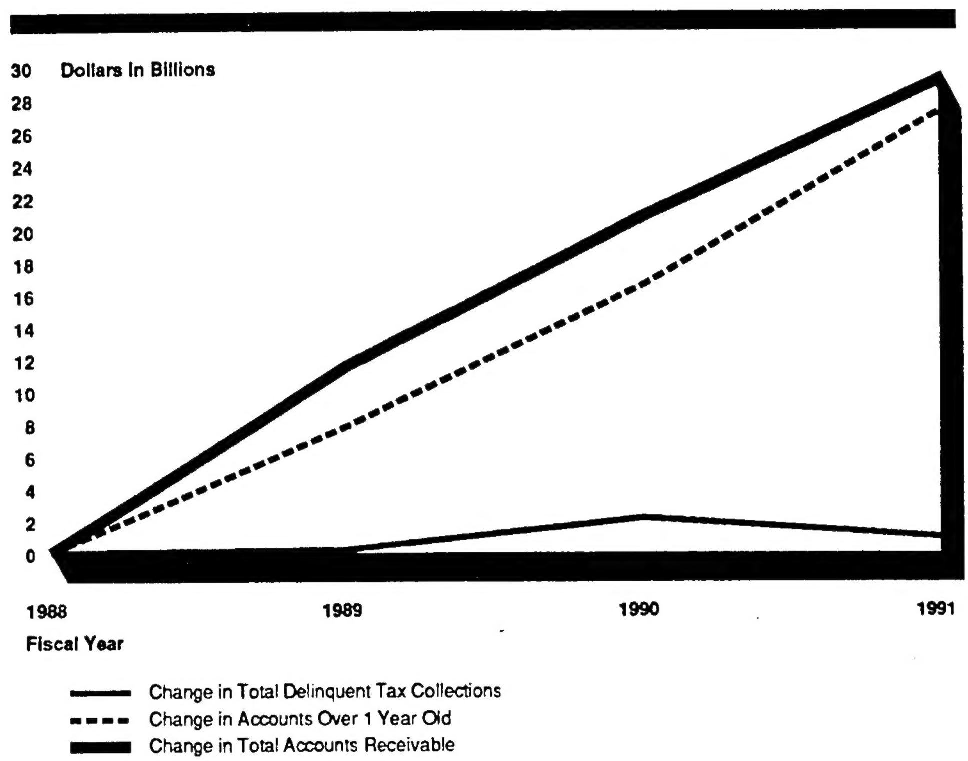
Collection's budget for next year, for example, has been reduced by $10.5 million and 303 FTEs because of anticipated savings from the "connectivity" project. This project provides operators at the automated call sites access to three data systems from one terminal. Despite the budget reduction, Collection has yet to identify personnel savings from this project and asserts that the improved access to data means that operators will take more time with each taxpayer.

Similarly, Examination's budget for 1993 has been reduced by $4.8 million and 116 FTEs because of anticipated savings from a TSM project--the Totally Integrated Examination System. Examination staff told us, however, that the system has been delayed for 6 months to 1 year, pushing back the complete "roll-out" of the system to 1994 and calling into question the validity of the projected savings.

TRENDS IN ENFORCEMENT WORKLOAD AND RESULTS

IRS' inability to sustain any growth in Examination and Collection staff comes at a time of increasing workloads and decreasing results. Figure 1 and table 2 show various trends in Examination and Collection workload and results.

Figure 1: Changes in Delinquent Tax Collections and Accounts Receivable



Note 1: All values include interest and penalties on Individual and Business Master File accounts.

Note 2: Fiscal year 1991 inventory and age data have been adjusted from a 10-year to a 6-year statutory collection period.

Source: IRS data.

Table 2: Trends in Certain Indicators of Examination Workload and Results

	Fiscal Year			
	Actual 1990	Actual 1991	Estimated 1992	Estimated 1993
Number of returns filed (thousands)[a]	118,431	121,141	122,674	123,423
Number of returns examined (thousands)[b]	993	1,221	1,120	1,069
Percent audit coverage	0.84	1.01	0.91	0.87
Recommended tax and penalties (billions)[c]	$22.0	$31.4	$19.1	$18.6

Note: The data on number of returns filed, number of returns examined, and percent audit coverage relate to income, estate, gift, and partnership returns.

[a]These are the number of returns filed in the prior year because the returns IRS audits in a given fiscal year will generally be those filed in the prior year.

[b]Although staffing levels are a contributing factor to changes in the number of returns examined, there can be other causes. IRS says, for example, that its workload has shifted from comparatively simple returns to more complex ones.

[c]According to IRS, the amount for fiscal year 1991 was so high because of a few large case closures, including one for over $6 billion.

Source: The data for 1990 are from IRS' budget estimates for fiscal year 1992. The data for the other years are from IRS' budget estimates for fiscal year 1993.

Accounts Receivable and Delinquent Tax Collections

The trends in accounts receivable and delinquent tax collections reflected in figure 1 are not good. The total accounts receivable inventory, including accrued penalties and interest, grew almost 15 percent, from $96.3 billion at the end of fiscal year 1990 to $110.7 billion at the end of fiscal year 1991. IRS now estimates that $29.1 billion of this amount is collectible. Besides growing larger, the inventory also grew older. The dollar value of accounts over 1 year old increased 16 percent from $65.6 billion to $76.3 billion. Part of the increase in the age and size of this inventory can be attributed to the extension of the statutory collection period from 6 to 10 years that took effect in 1991. To account for this change, we adjusted the 1991 accounts receivable data used in figure 1 to show what the trend

would be if the 6-year period were still in effect. Even with the adjustment, the trends are bad.

As shown in figure 1, total delinquent tax collections failed to keep pace with the growth in the accounts receivable inventory and actually declined by 5 percent from fiscal year 1990 to fiscal year 1991. That decline may have resulted in part from the poor economic conditions last year and taxpayers' reduced ability to pay.

Although total collections declined, IRS reported that collections attributable to the actions of revenue officers and automated collection site staff increased by 3 percent. This increase was less than the year before and $43 million less than IRS expected considering the hiring of additional staff.

Audit Coverage

In previous years' testimony on IRS' annual budget request, we have noted the low level of audit coverage over all classes of taxpayers as reflected in table 2. This year, we take special note of the coverage of one particular group of taxpayers that has been shown to have an alarming level of noncompliance: small corporations--those with assets below $10 million.

IRS' most recent surveys of small corporate tax compliance, done under the Taxpayer Compliance Measurement Program, involved returns filed in 1980 and 1987. The survey of 1987 tax returns showed that small corporations voluntarily paid only 61 percent of the total tax owed, a drop of 20 percentage points from the 1980 rate of 81 percent. At the same time, audit coverage of this taxpayer group decreased from 6.1 percent in 1980 to 1.1 percent in 1987.

Although the dramatic dips in both compliance and audit coverage may be coincidental, recent research indicates that the corporate owner's perceived risk of audit does affect the rate of tax compliance. In 1992, IRS plans to increase its audit coverage of small corporations to 2.8 percent from the 1991 rate of 1.8 percent. Although this increase would be a clear improvement, the planned coverage is still less than one-half that of 1980. We are aware that IRS continues to study the causes behind the small corporation rate of compliance, but we remain concerned about the relatively low rate of audit coverage.

REDUCTION IN SIZE OF INFORMATION RETURNS PROGRAM

The fiscal year 1993 budget request also projects a significant reduction in the Information Returns Program--a cut of almost 25 percent, from 5,609 FTEs in 1991 to 4,302 FTEs in 1993.

Information obtained from IRS indicates that the staffing cutbacks since fiscal year 1991 have had a substantial impact on the Information Returns Program. For example, the Austin Compliance Center screened about 816,000 underreporter cases in 1991. In 1992, it expects to screen about 530,000 cases--a 35 percent reduction from last year. Overall, IRS projects a workload of 5.6 million underreporter cases in 1992, 3.4 million (38 percent) less than its 1991 workload.[1]

Part of the staff reduction (148 FTEs) resulted from projected productivity savings from the Automated Underreporter System being installed as part of TSM. These savings were based on the system being on-line in the Ogden Service Center for all of 1992, with two other service centers on-line by the end of the year. According to a program official, however, the system was not installed in Ogden until February, 4 months late, and it is doubtful that either of the other 2 service centers will be operational before year's end. Thus, the 148 FTE cut will not be offset with productivity gains and will result in a net reduction to the Information Returns Program.

The largest single reduction to the Information Returns Program came after Congress cut the 1992 budget proposed for IRS by about $50 million. Technically, Congress cut the costs associated with Examination and Collection initiatives proposed for 1992. These costs included labor costs for additional staff and indirect support costs such as rent and equipment. Faced with this cut and increased rental charges, IRS decided to eliminate the labor costs in the 1992 initiatives but not the support costs. Instead of reducing the support costs, it cut staffing for the Information Returns Program. This cut removed 592 staff years and $13 million from the Information Returns Program.

This budget cut had a sizeable impact on the underreporter program's operations. After the cut, more than 2 million underreporter cases were dropped from the projected caseload and many employees were removed from the program. A Fresno Service Center official, for example, said that because of the cut, the Center reduced its workload by 176,000 cases which, he estimated, would have brought in between $7.8 million and $15.7 million. He said also that about 100 employees were cut from the program and transferred to other service center units. An Austin Compliance Center official said that about 200 temporary employees were released from the underreporter program there and offered jobs at the Austin Service Center.

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[1]In fiscal year 1991, the Information Returns Program primarily screened cases from tax year 1988; in fiscal year 1992, it will mainly screen cases from tax year 1989. The national workload figures cited in this sentence represent the caseloads from those tax years.

IRS OPERATIONS REDUCED DUE TO PRODUCTIVITY "SAVINGS"

American taxpayers have a right to expect to see some payback from what will eventually be billions of dollars of investment in IRS' systems modernization efforts. Reflecting that expectation, IRS' budgets for fiscal years 1992 and 1993 included, in total, about $90 million in expected productivity savings from the implementation of various automation projects. Many of the productivity savings included in those budgets, however, appear to have been based on unrealistic assumptions.

Although $90 million is less than 1 percent of IRS' budget requests for those 2 years, the effect is that programs are being arbitrarily cut to reflect productivity "savings" that are not really there. IRS officials we talked to acknowledged that IRS needs to do a better job of determining what the modernization-related savings will be and when they will be realized.

Productivity "Savings" in Fiscal Year 1992

In our testimony before the Subcommittee on IRS' fiscal year 1992 budget request, we noted that productivity savings included in that budget might not be realized.[2] Our follow-up inquiries this year indicated that our skepticism was well founded. Although IRS cut its operating budget to reflect those "savings", the cuts were not tied, for the most part, to increased efficiency from automation projects, but rather, to general "assessments" of program operations.

Among the compliance operations, we have already noted the questionable savings taken in the Information Returns Program. Another 1992 "savings" was due to expected productivity increases from the use of new lap-top computers by Examination staff. Although Examination has taken a $4.2 million cut in its budget, it is unlikely that there will be any significant savings from the new personal computers this year. Due to delays in the procurement process, none of the lap-tops are expected to be purchased before May.

The 1992 budget targeted savings of 902 FTEs in Returns Processing because of enhanced productivity due to electronic filing and the on-line entity project. As a result, each service center was required to take a 2 percent cut. We talked to officials in the Austin and Cincinnati Service Centers about those cuts. Cincinnati reduced its operations by 72 staff years; however when asked to estimate the actual savings from the two computer systems, officials identified about 6 staff years. Austin cut its operations by 47 staff years. Austin officials

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[2]IRS' Budget Request for Fiscal Year 1992 and Status of the 1991 Tax Return Filing Season (GAO/T-GGD-91-17, Mar. 20, 1991).

said, however, that although the new computer operations will eventually result in savings, less than 5 staff years had actually been saved so far.

Productivity "Savings" for Fiscal Year 1993

IRS' fiscal year 1993 budget request includes estimated productivity savings of $52 million and 1,463 FTEs due to efficiencies to be gained from new computer operations. Table 3 shows the amount of savings by function.

Table 3: Estimated Productivity Savings in IRS' Fiscal Year 1993 Budget

Function	Dollar Savings (millions)	FTE Savings
Returns Processing	$13.4	437
Taxpayer Service	11.4	295
Examination	4.8	160
Collection	10.0	326
Information Reporting	7.9	237
Information Systems	4.6	8

Source: IRS Budget Estimates for Fiscal Year 1993 President's Budget.

According to information obtained from IRS officials, only about 36 percent of the staff savings specified in the 1993 budget request can be matched to actual staff time reduction due to a new or enhanced computer system. Where projects deal with an enforcement operation, this percentage dips to 24 percent.

Among the non-enforcement activities, there are mixed reactions to the 1993 productivity "savings." Returns Processing claims the highest percentage of actual savings, tying 54 percent of the savings to work activities. Those savings are attributed to implementation of a new system know as Corporate Files on Line and expansion of Electronic Filing. Taxpayer Service, however, does not expect to realize any of its projected savings from Corporate Files on Line, arguing instead that this system will lengthen the time an assistor is on the phone with a taxpayer because it expands the data to which the assistor can refer.

Enforcement activities have had a harder time identifying much "savings." We previously discussed Collection and Examination officials' views on projected savings in their areas. Information Returns Program officials cited delays in implementation of the Automated Underreporter System as limiting

actual savings to 43 percent of the amount included in the 1993 budget.

IRS NEEDS TO DO A BETTER JOB OF IDENTIFYING BENEFITS FROM SYSTEMS MODERNIZATION

We understand the administration's desire to show some benefits from IRS' ever-increasing TSM budget, and IRS has recognized the need to do a better job of identifying those benefits. Toward that end, IRS established an office under its Chief Operations Officer to better coordinate its computer systems projects with its operational functions.

At the heart of this office's efforts is an increased emphasis on the development of a sound "business case" for each TSM project. Prepared by operational personnel, these business cases are intended to present solid operational benefits to justify continued funding of a TSM project and are to be updated on a quarterly basis for submission to the Office of Management and Budget.

Business case requirements have provided the impetus for detailed studies to pinpoint the time saved by technology improvements. Within Returns Processing, for example, there is a project ongoing at the Memphis Service Center to better understand the processes that ultimately will be affected by Corporate Files on Line. Where an operation is found to be affected by the new automation, actual savings will be calculated by measuring operation "run" time.

While acknowledging these efforts, we believe the time is right for IRS to take a bolder approach in assessing the business opportunities of TSM. In requesting our testimony, the Subcommittee indicated an interest in waste within IRS. We believe that IRS' operation has much built-in waste--unproductive work and rework necessitated in large part by obsolete processes and systems that prevent IRS from doing its job most efficiently.

IRS' current organizational structure takes a fragmented view of the taxpayer, with distinctly separate operations for returns processing, taxpayer service, examination, collection, and other enforcement activities. These different IRS functions generally maintain their own case files, records, and management information systems. As a result, taxpayers may deal with many different IRS employees to resolve problems.

This functional fragmentation manifests itself in a variety of ways--for example, taxes that are assessed by Examination's auditors are frequently overturned at the appeals stage or are abated by the Collections function; multiple contacts are made with the same taxpayer by different IRS functions without coordination; and a baffling and complex organization faces

taxpayers seeking to resolve problems. A further consequence has been the creation of management information systems that cannot track taxpayers, programs, or issues across various functions in the IRS system.

Redundancy and inefficiencies are fostered by the longstanding IRS field structure. Programs and services, such as corresponding with taxpayers and identifying underreporters, are replicated in each of IRS' 10 service centers. Other services that depend on service center files, such as telephone call sites, are scattered at even more geographic locations. Collection calls are made from 23 automated call sites while taxpayer assistance calls are answered at 32 different locations.

This field structure was premised on the constraints of the technology that was adopted by IRS over 30 years ago. Limited central computer capacity and accessibility to the central master files of taxpayer accounts encouraged IRS to decentralize these programs to connect with smaller databases of taxpayers located at service centers. However, operating redundant programs at all of IRS' field locations is costly, fosters recruiting problems at various locations, and has led to disparate treatment of taxpayers across the different IRS field offices. For example, the 32 taxpayer assistance call sites have differing track records on accuracy and accessibility, resulting in uneven service to taxpayers across the country.

TSM is expected to eliminate some of these problems. How much is eliminated will depend on how far IRS is willing and able to go in changing its business operations. As we have testified in the past, these opportunities might include the consolidation of field locations, the establishment of cross-functional telephone service, and the merging of enforcement functions into a single compliance unit.[3]

With the opportunities afforded by TSM, IRS has to ask itself whether its current organizational structure still makes sense. It needs to question the number and/or makeup of its regional and district offices, its service centers, and its call sites and suboffices. Will it still be necessary, for example, for all 10 service centers to do the same thing? Would it be more efficient to consolidate certain activities such as correspondence, document matching, or notice review in one or two centers rather than having each center do each of those things? Consolidation could help to ensure more consistency in the handling of cases and in the application of procedures and more efficiency in such things as oversight, hiring, training, and the use of technology.

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[3]Identifying Options for Organizational and Business Changes at IRS (GAO/T-GGD-91-54, July 9, 1991).

IRS' decision on how to handle an increasing demand for electronic filing demonstrates its seeming inclination to make all 10 service centers replicas of each other. This year, to meet demand, IRS expanded the number of centers equipped to receive electronic returns from three to five. As IRS expands the availability of alternatives to the traditional way of filing tax returns and modernizes its systems for processing returns, it needs to determine whether it makes sense from a business standpoint to do everything at every center or whether it makes more sense to dedicate specific centers to handle specific types of returns or specific types of filings. Consolidating electronic filing, for example, might help IRS bring the necessary human and technological resources to bear in trying to detect and stop fraudulent refunds--a growing problem with electronic filing.

This Subcommittee can play an important oversight role in helping to ensure that IRS fully explores the business opportunities afforded by TSM and that the taxpaying public realizes the fullest benefits from its investment.

ADEQUACY OF PROPOSED RESOURCES FOR TAXPAYER SERVICE

IRS' budget request for fiscal year 1993 includes $376 million and 8,354 FTEs for Taxpayer Service--a decrease of $3.7 million and 160 FTEs from the authorized levels for fiscal year 1992.

As we testified before this Subcommittee in March 1992, IRS data indicated that taxpayers were having trouble this year getting through to IRS' toll-free telephone assistors.[4] Using IRS data on the number of calls received and the number answered, we had computed an answer rate of 27 percent as of March 7, 1992--a considerable drop from the 42 percent answer rate the year before.

Such a low answer rate might suggest the need to reallocate resources, redirect calls, or add resources. If the latter, it would call into question the adequacy of the requested budget for Taxpayer Service. However, IRS says it has reason to believe that it has been getting bad information from the telephone system on the number of calls coming in and that, therefore, its answer rate might be much better. IRS is currently assessing the reliability of its data, and we are monitoring that effort as part of our review of the filing season for the Subcommittee. After completing its assessment, IRS should determine whether its

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[4]Tax Administration: Federal Contractor Tax Delinquencies and Status of the 1992 Tax Return Filing Season (GAO/T-GGD-92-23, Mar. 17, 1992).

proposed Taxpayer Service resources are adequate and apprise Congress of the results.

ALLOCATION OF RESOURCES WITHIN THE CRIMINAL INVESTIGATION DIVISION

You asked us, as part of our statement, to comment on the adequacy of resources for IRS' tax fraud and financial investigations. The fiscal year 1993 budget request includes $335 million and 4,756 FTEs for those investigations--an increase of $23 million and 41 FTEs over the amounts authorized for fiscal year 1992. Included in that increase are 19 FTEs and $3.1 million for increased investigations involving illegal income (such as cases involving narcotics and money laundering) and like amounts for increased investigations involving legal-source income (such as white collar tax crimes).

Tax fraud and financial investigations are the responsibility of IRS' Criminal Investigation Division. Concerns have been expressed about whether that Division is paying sufficient attention to legal income cases given the recent downward trend in special agent staffing for and investigations of these type cases. Even with the increase called for in the fiscal year 1993 budget, special agent staffing for legal income cases will have dropped about 11 percent since 1986. At the same time, overall funding for tax fraud and financial investigations will have increased by 51.4 percent. IRS data also show that investigations of legal income cases and prosecution recommendations related to such cases dropped 19.2 percent and 22.5 percent, respectively, from 1986 to 1990.

IRS' expanded role in the government's "war on drugs" has been a major contributor to the shift away from legal income cases. We are in no position to question that role, nor have we seen compelling data on any adverse effects of that shift--information, for example, on how decreasing presence in the legal income area adversely affects compliance.

COORDINATED EXAMINATIONS OF EXEMPT ORGANIZATIONS

You also asked us to comment on the adequacy of resources in IRS' budget request as it relates to tax-exempt organizations. In the past year, IRS has begun using coordinated examination procedures to audit large exempt organizations. As of March 1992, there were 45 coordinated examinations underway. Exempt Organization officials said that although the initial focus of these audits has been on hospitals and universities, they are looking at the possibility of expanding use of the coordinated examination procedures to other types of large exempt organizations, such as utilities.

According to Exempt Organization officials, IRS is auditing only hospitals and universities that are included among the approximately 2,600 largest U.S. exempt organizations (with either assets or income over $50 million). IRS issued audit guidelines for hospitals on April 1, 1992. According to officials, the audits will be used to develop additional guidelines for doing coordinated examinations not only of large organizations but also of smaller hospitals and universities.

Despite a shift to more comprehensive coordinated examinations, IRS' budget request projects a sizeable increase in the number of exempt organization audits (from 14.4 million in fiscal year 1992 to 19.2 million in 1993) without a corresponding increase in staff. An Exempt Organization official told us, however, that the fiscal year 1993 projection has since been revised to about 13.3 million.

Although the current policy effectively limits the number of audits below the number that would have been done in the past, we believe that the revised strategy will lead to better audits than were done in the past. We would expect IRS to carefully monitor the results of these first coordinated examinations to see if it can use this type of audit to strengthen its overall coverage of exempt organizations.

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That concludes my statement. I would be happy to respond to any questions.

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